BEFORE

THE PUBLIC SERVICE COMMISSION

OF SOUTH CAROLINA

DOCKET NO. 90-266-C - ORDER NO. 90-1009

OCTOBER 19, 1990

IN RE:	Generic Proceeding to Consider Intrastate Incentive Regulation	)))))	ORDER RESCINDING ORDER NO. 90-986, DENYING PETITIONS FOR RECONSIDERATION AND AFFIRMING AND CLARIFYING ORDER NO. 90-849

On October 10, 1990, the Public Service Commission of South Carolina (the Commission) issued Order No. 90-986 wherein the Commission denied the separate Petitions for Rehearing and Reconsideration filed on behalf of the South Carolina Cable Television Association ("SCCTA") and Steven W. Hamm, the Consumer Advocate of South Carolina ("Consumer Advocate"). The Commission hereby rescinds all provisions of Order No. 90-986 and in its place and in lieu thereof, issues the instant Order.

The Petitions filed by the SCCTA and the Consumer Advocate seek rehearing of this matter. Neither Petitioner has provided grounds in support of rehearing, and the requests are denied. Additionally, for the reasons to follow and based upon a review of the Petitions and the substantial evidence of the record, the Commission has determined that it should not reconsider Order No. 90-849, however, the Commission has determined that it should clarify certain aspects of Order No. 90-849. Based upon a review

of the record and applicable laws, the Order No. 90-849 is affirmed, incorporated herein by reference and modified by the findings and conclusions contained herein.

Order No. 90-849 does not allow any telephone utility to increase its rates and charges without a proper showing nor does it allow a telephone utility to reap profits in excess of that level which would constitute a fair return. Indeed, should a telephone utility wish to either increase its rates or its authorized rate of return, it must comply with the statutory requirements of South Carolina Code Section 58-9-540 (Law. Co-op. 1976, as amended). In such an instance, the Commission will continue to adhere to the statutory mandate of Code Section 58-9-570. In short, the regulatory framework within which local exchange companies operate in South Carolina has not been changed by this Order.

Rather, the Commission simply has announced its intent, for local exchange companies to have the opportunity to request, on an optional basis, regulatory treatment that utilizes a rate of return range within which a utility may conduct its operations in South Carolina under certain circumstances. In most cases, the Commission has reached a specific rate of return on either equity or rate base, as appropriate, in addressing its legal duty to allow a utility the opportunity to earn a fair return on its jurisdictional investment. The practice of identifying a specific return or a rate of return range, however, is not mandated by statute.

In giving the local exchange companies the opportunity to request incentive regulation treatment which would allow them to function somewhat more freely than under traditional rate of return regulation as currently practiced by this Commission, the Commission has announced this change in policy as a trial. A utility wishing to avail itself of this incentive form of regulation, if granted, may so operate for only a maximum of a three-year period. Quarterly and annual reports of earnings will continue to be filed with the Commission. At the end of the trial period, or at any time during the trial period, the Commission, in its regulatory expertise, can either suspend the trial or continue it, depending upon the flow and balance of benefits to the ratepayers and the shareholders.

Having addressed, then, in general terms, the Commission's goal in adopting Order No. 90-849, the specific allegations of the SCCTA and the Consumer Advocate will be addressed. First, the SCCTA asserts that the Commission failed "to properly address the most critical issue required prior to adopting any incentive regulation plan: will the consumers be better off under 'alternative' regulation than under traditional telephone regulation."

The Commission considered the impact of incentive regulation on the consumer in Order No. 90-849. In concluding that there is a public benefit to be derived from a modification of the traditional rate of return regulation, the Commission necessarily considered the question of the benefits to the ratepayers, to wit: the

enhancement of economic development; stable, affordable rates; the prompt introduction of innovative services; reduced cost of service. Order No. 90-849, p.6. The Commission's conclusion was not based on conjecture as alleged by the SCCTA; the record fully supports the Commission's determinations.

The SCCTA would have the standard for change be that traditional ratemaking has "damaged" the telephone infrastructure in South Carolina before a new methodology could be adopted by the Commission. Such a showing would not be in anyone's interest, and particularly not in the public interest in South Carolina. The Commission will not allow the telephone infrastructure in South Carolina to be damaged or neglected in any way as a result of its regulatory practices. The move by the Commission to allow LEC's the opportunity to seek incentive regulation is made to assist the LEC's to remain in the forefront of technological changes, not to just react to events as they happen.

The record before the Commission convincingly supports the establishment of a trial refinement to telephone utility regulation in South Carolina. As stated by AT&T witness Follensbee:

> Changes in the telecommunications industry, such as rapid advancement in technology and the advent of competition in certain markets, warrant the consideration of an alternative to traditional earnings regulation for the LEC's.
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> (Tr. Vol.I, p. 93)

The Commission agrees that alternatives to traditional regulation should be considered in this instance, but the foremost consideration is the protection of the using and consuming public. The Commission, in clarifying Order No. 90-849 so that there will be no confusion as to the Commission's intent to consider the impact of incentive regulation on the ratepayer and its intent to provide safeguards for the ratepayers' protection, has determined that annual filing requirements should be used to a certain extent as indicators of the impact of incentive regulation on the ratepayers and the opting LEC's. These filing requirements are incorporated herein and attached hereto as Appendix A. In brief, the filing requirements follow the objectives listed by Contel witness Spencer (Tr. Vol. I, p. 119). The Commission will require the LEC's to annually file information identifying revenues, expenses and investments in utility services. These filing requirements will be filed on a total company regulated and intrastate South Carolina regulated basis. Additionally, the Commission will require the opting LEC to file a consolidated cash flow (sources and uses of funds) statement for earnings on operations in South Carolina, as well as a verified statement concerning operational efficiencies and any other consumer benefits it feels have been achieved by virtue of this refinement to the utility's regulatory treatment. These requirements may be amended from time to time as conditions warrant or as may be suggested by participating parties during the course of the proposed filing by the opting LEC under appropriate circumstances and will be set up

for each LEC filing under its proposed incentive regulation plan before the LEC implements its plan, if approved. The purpose of these filing requirements is to provide information which will allow the Commission to review technological innovations and services and improved operating productivity to determine whether the LEC opting under incentive regulation should be allowed to continue this regulatory treatment or to take any other action, as appropriate.

The Commission has not deregulated the local exchange companies. Their earnings, quality of service requirements, non-discrimination edicts, in short, the entire regulatory scheme in South Carolina, has not been changed by Order No. 90-849. In fact, with the safeguards outlined above and incorporated as Appendix A, the Commission is requiring more accountability for those LEC's opting under the incentive regulation plan than those LEC's continuing under the traditional regulatory approach. To enjoy the benefit of retaining additional earnings and sharing earnings with its ratepayers, the participating LEC has the burden of demonstrating increased efficiencies and productivity and must be accountable for making appropriate investments in its regulated activities.

Next, the SCCTA asserts that competition is not present in the LEC's businesses and that the Commission erred in so finding. Error exists, the SCCTA alleges, due to the absence of empirical data to support claims of competition in the industry. The Commission again disagrees. While the Commission did not quantify

the level of competition in the LEC's in South Carolina, it did specify the various competitive services in the market in South Carolina today. More than mere "allusions" to competition were made by the various witnesses before the Commission, specific examples were cited and the Commission found that competitive services are, in a "generic" sense, pervasive throughout South Carolina. The term "generic" as used by the Commission means that competition exists to such an extent that every LEC, as a group, is affected by competition. The substantial evidence of the record supports the Commission's finding.

This Commission, since 1984, has issued over 737 Certificates of Public Convenience and Necessity to carriers of all descriptions who compete directly with the local exchange companies. It is immaterial to the decision to implement, on a trial basis, an optional regulatory practice, whether the LEC's revenues lost to competition are ten million dollars or one hundred million dollars. The simple fact is that competition, directly, indirectly or in a generic sense, is in South Carolina today and other forms of such competition, will, in all probability, be here in the future.

It is clear that if telephone utilities are to have the long-term incentive to seek new efficiencies, to seek new services and to modernize their networks, the Commission must afford them some latitude in their ability to strive toward achievement of these goals. The Commission remains convinced that, given the competitive changes within the telecommunications industry, it must seek proactive alternatives, within the statutory confines mandated

by the Legislature to allow the LEC's the opportunity to deal with such changes. As stated by witness Walker:

> The telecommunications services marketplace is in transition from monopoly to competitive based. Rapidly expanding telecommunications technology, which is available to virtually everyone, is the primary driver of this marketplace change.
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> * * *
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> Consequently, just as the marketplace is evolving, the regulatory process must also evolve.... Refinements to the regulatory process must occur regardless of how successful past regulatory practices have been. Therefore, now is the time to make the regulatory refinements that are in the public interest of the citizens of South Carolina.
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> The ratepayers, the cities and communities, the Commission and the local exchange companies in South Carolina would all receive benefits from a well-designed incentive regulation plan.
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> Likewise, investors are sensitive to regulatory actions which affect telecommunications companies. To the extent that incentive regulation plans work out well and show promise, of facilitating long-term efficiencies, investors view this new approach favorably.
> Tr. Vol. II, pp. 77-78.

In its second allegation of error, the SCCTA asserts "... even the presence of purported generic competition is an insufficient basis for deregulating the LEC's." (Petition at p. 5). In an exercise of what can best be described "judicial/administrative efficiencies," the Commission has announced a change in its granting of a specific rate of return. The local companies not opting to apply to the Commission under incentive regulation continue to be regulated exactly as they were prior to September 5, 1990. No local company has been deregulated by Order No. 90-849.

Next, the SCCTA raises an issue similar to that already addressed herein. The SCCTA would have the Commission make a finding prior to the decision to implement incentive regulation that traditional regulation cannot meet the challenge of competition in the provision of LEC services. Without evidence of the deficiencies in service or deployed technology, the SCCTA asserts the Commission cannot reach the conclusion it did concerning the need for a trial of this modification to the regulation of telephone utilities. Again, the Commission disagrees.

The Commission's charge by the Legislature to authorize a "fair rate of return" is found in S.C. Code Ann. Section 58-9-570(1976). No where in that section are the means by which the Commission's action in this regard is to be carried out specified. Certainly, there is no obligation, as alleged by the SCCTA, that the Commission may not "fix" something that is not "broken." The Commission's optional incentive regulation plan gives those qualifying LEC's the opportunity to increase efficiencies and productivity which would benefit the ratepayer and thus have the opportunity for improved earnings of the LEC. This will give those LEC's opting and qualifying under incentive regulation the opportunity to remain in the vanguard of providing innovative technologies and quality, affordable service to their customers. However, to have this unique opportunity, the LEC must be willing to comply with the safeguards outlined herein and as they may be further refined in future proceedings.

Under the view of the SCCTA,this Commission's regulatory role would be relegated to reactive as opposed to proactive in protecting the interests of the local ratepayer. That view of the Commission's responsibility is contrary to it's ability to serve the public interest in South Carolina. Given the state of competition and technology, the Commission's regulation of telephone utilities should be refined.

The SCCTA warns the Commission of changing its policy and allowing LEC's "to charge excessive rates and thus overearn substantially a fair rate of return." However, the Commission is of the opinion that filing requirements can be used as a mechanism to provide the necessary safeguards to maintain the necessary Commission oversight of the LEC's allowed to participate in any incentive regulation plan.

The SCCTA further alleges error on the part of the Commission's not justifying incentive regulation in accordance with the statutory mandates of S. C. Code Section 58-9-330. The statute to which the SCCTA refers provides as follows:

> For the purpose of encouraging economy, efficiency and improvements in methods of service any telephone utility may participate, subject to the approval of the Commission, to such extent as may be permitted by the Commission, in the additional profits arising from any economy, efficiency or improvements in methods or service instituted by such telephone utility.

Much of the testimony offered by the parties in this case dealt with the need to offer incentives to the utilities to operate more efficiently. For example, Contel witness Spencer offered his view of five objectives of any incentive plan:

> An incentive regulation plan should meet the following objectives:
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> 1. Technological innovation: The plan should encourage LEC's to invest in new technology with the goal of providing improved services and lower costs.
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> 2. Introduction of innovative products and services: The plan should provide LEC's the financial incentive to explore and market new products and services.
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> 3. Financial incentives for improved operating productivity: The plan should provide LEC's with financial rewards for improved productivity leading to reductions in the long-term cost of providing service.
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> 4. Pricing flexibility: In markets where prices are driven by competitive forces, LEC's should be allowed to price services with reduced regulatory oversight.
>
> 5. Administrative simplicity: The plan should not increase the cost of regulation through excessive monitoring and reporting requirements.
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> (Tr. Vol. I, p. 119)

Similarly, witness Jensik of GTE testified:

> A modern telecommunications network is critical to the South Carolina economy. By establishing an environment which promotes the development of an advanced communications network a Local Exchange Carrier (LEC) can cut costs, boost overall efficiency and become more productive. Increased productivity leads to a stronger economy, and a stronger economy offers a competitive edge in attracting jobs to South Carolina. A state with a competitive edge will provide its citizens with more jobs and a higher standard of living.
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> (Tr. Vol. II, pp. 40-41).

The action of the Commission in this docket is in full concert with the statutory sharing mechanism relied upon by the SCCTA as well as Section 58-9-570. Under the incentive regulation Order, however, not only does the efficient utility participate in additional profits arising from its improvements, but the ratepayer shares as well if the earnings are above a designated threshold. It is the ability to share in the earnings above a designated threshold of an allowed range that should spur the companies to improve efficiencies and productivity and adopt a more competitive mindset. This setting of a benchmark rate of return with the utility being allowed to retain earnings within a specified range and then allowed to share additional earnings above a threshold with its ratepayers then, is complementary to, and not in conflict with, Code Section 58-9-330.

The SCCTA next asserts that the Commission erred in not expressly providing in its plan assurances that any additional profits which the LEC enjoys is derived only from economies, efficiencies, and improvements. The SCCTA suggests the a LEC must have a baseline return set in a new rate case. The Commission agrees with this suggestion, and has provided for that in Order No. 90-849. As noted in Order No. 90-849, each LEC requesting treatment under incentive regulation, must file its request with the Commission and the Commission will establish a proceeding to determine the benchmark rate of return. This benchmark proceeding will bring the utility's operations and earnings up to date and any necessary adjustments will be made at that time. Also, the required

filings of the participating LEC will assist the Commission in monitoring the expenses to ensure that sufficient economies and efficiencies are being derived to allow the continued participation in incentive regulation.

Next, the SCCTA outlines five additional protections the Commission should adopt in its incentive regulation plan. First, it argues that whatever portion of enhanced profits are to be shared by the ratepayers, must be routed to the ratepayers and not to LEC capital projects (Petition at p. 13). The Commission heard numerous suggestions as to how any "excess" earnings should be shared with the public. As stated in Order No. 90-849, "[t]he manner of refunds or sharing revenues would be separately handled for each LEC ... during the proceeding to establish the benchmark." Order, p. 9. The Commission would also have the option and the opportunity to address the sharing issue in a later proceeding when there would be earnings over the threshold experienced by the LEC. It may be more appropriate at that time to make a sharing decision, based upon the circumstances existing at the time the earnings are at the sharing level.

The range established by the Commission for sharing is next alleged by the SCCTA as, in essence, having no upper limit. The Commission disagrees. Staff witness Walsh recommended a total spread of some 350 basis points (Tr. Vol. I, p. 16, Hearing Exhibit One). Witness Jensik proposed a range of some 550 basis points (Tr. Vol. II, pp. 52-54). Clearly then the spread from floor to ceiling of 450 basis points established by the Commission is within

the confines of the record and any excess earnings over the established ceiling will flow to the ratepayer. Order No. 90-849, p. 12.

Next, the SCCTA argues that the filing of annual reports by jurisdictional telephone utilities operating under incentive regulation is "... simply too long." Following each twelve month, historic test period of actual data, including the required annual filings, the Commission will inquire, under an incentive regulatory approach, into the utility's earnings and deal with such appropriately. (See, Tr. Vol.I, pp. 22-23). The quarterly reports already required to be filed are still required by the Commission. These reports are used to monitor earnings and if quarterly surveillance reports reveal some inappropriate level of earnings, the Commission has existing means to "show cause" the utility or take appropriate action.

The SCCTA next voices concern about the need to establish sanctions in this docket should a utility disobey a Commission order. The ability to deal with a utility's disobedience already exists. Code Section 58-9-390 requires each utility to obey orders of the Commission and Code Section 58-9-770 provides the procedural mechanisms by which disobedience may be stopped, and Code Section 58-9-1610 provides for the imposition of monetary penalties for failure to obey a lawful Commission order. The Commission may also take the LEC out from under the incentive regulation plan. The inherent and express powers of the Commission to enforce its Orders are sufficient and need not be redefined in this proceeding.

The SCCTA requests that a "rate moratorium" be incorporated into any plan. During the SCCTA cross-examination of Staff witness Walsh, the impact of a rate moratorium at New York Telephone, as discussed in the SCCTA Petition, was debated.

Q. If a situation were to develop in South Carolina with an LEC similar to that which developed with New York Tel under the earnings sharing plan adopted in New York, would the staff recommend that the Commission be permitted to re-enter the picture, if you will, and require that the LEC return to a traditional return on rate base or equity approach to regulation?

A. I think the plan that I have recommended to the Commission takes care of an instance in that case. For instance, a local exchange company that may opt to become incentive regulated, if their benchmark is established at a return on equity of 13 percent, the plan that I have recommended would require that LEC to eat earnings or the loss of earnings down to 12 percent prior to filing any type of rate relief. Now, once the company dropped that 100 basis points below the benchmark, they could then file traditional rate relief, as I understand it.

Q. So am I correct, then, in summarizing your comment that a portion of the loss or a portion of the underearnings, if you will, will be borne by the shareholders of the LEC, but a portion would also be borne by the ratepayers?

A. The portion of underearnings that would be borne by the shareholders would be that deficit of 100 basis points below the authorized return once it dropped to, let's say 150 basis points, then that in fact could trigger the local exchange company to file a traditional rate case.

Q. Mr. Walsh, if the LEC's come before the Commission and they say, "We want to be regulated under an alternative plan" and, if earnings sharing is what is adopted, they come before the Commission and say, "We want to be regulated under the earnings sharing plan," and if the LEC stumbles in the manner that New York Tel stumbled, why should the ratepayers be required to bear any portion of the burden that would result from such a mishap, if you will?

> A. I think that the actual concept of earnings sharing does what it's supposed to do. If a benchmark is there of 13 percent, the company can retain earnings up to 14 percent, but the company also takes the risk of having to eat earnings below that level down to 12 percent. Whereas if this company was under traditional rate of return regulation, as earnings dropped to 12.5 percent on equity, they could then file a rate proceeding to adjust those rates. So, I feel like there is a sharing there. The company can share in above, but they also take the burden or the risk of their investors not recovering earnings below the level that's authorized by the Commission, down to 100 basis points below.
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> (Tr. vol. I, pp. 23-26).

The Commission has spread the risk, as urged by witness Sokol, "Companies entering into this optional regulatory reform plan are agreeing to take the full risk of falling 100 basis points below their authorized rate of return without petitioning for relief" (Tr. Vol. II, p. 149). There is, then, no public cushion for failure as, indeed, should a utility fall more than 100 basis points below its benchmark return, i.e. the bottom of its range, it must invoke the existing statutory scheme found at Code Sections 58-9-520, et seq. and abandon its ability to operate under incentive regulation.

Finally, the SCCTA asserts that the Commission failed to adequately set forth findings and conclusions. While the Commission disagrees, its Order No. 90-849 is further supplemented, clarified and modified by this Order and it is incorporated herein by reference.

The Consumer Advocate likewise filed a Petition for Rehearing and Reconsideration. As with the SCCTA Petition, those alleged grounds for error will be discussed individually. First, the Commission disagrees with the Consumer Advocate's position that an empirical study of the level of competition is required as a condition precedent to the adoption of an optional, trial refinement to existing rate of return regulation. The Commission is keenly aware of the level of competition in South Carolina (See Findings of Fact, Number 10) and the record supports the fact that competition exists in South Carolina. An empirical study is not required when witnesses cite a myriad of services being offered in South Carolina by providers other than local exchange carriers and the Commission itself has certified many of these alternative service providers. The existence of competition served as a catalyst for the Commission's decision to consider refinements within the existing statutory scheme.

The Consumer Advocate asserts that the Commission failed to make adequate findings of fact as to how local exchange ratepayers would be protected if the earnings of a LEC under incentive regulation fall below the established floor. The Commission will clarify Order No. 90-849 to address this concern of the Consumer Advocate.

The Commission finds that in the event a LEC operating under incentive regulation experiences earnings below the established floor, it may file for rate relief before the Commission. However, the Commission will examine the required reports filed under

incentive regulation to ensure that the company tried to achieve the goals of increased efficiency and productivity while providing reliable, affordable telecommunications services to it ratepayers. The ratepayers are protected to the extent the LEC must absorb earnings 100 basis points below the established benchmark. After that point, the LEC has the right to file for rate relief, but it would be under the current traditional rate of return regulation, and any imprudent expenditures would be taken into account in the Commission's scrutiny of the reasonableness of the LEC's expenses. Ratepayers are further protected by the reporting requirements outlined herein. Additionally, as noted previously, the Commission has various statutory provisions available to it, and the Commission is prepared to avail itself of every means to protect the public interest under incentive regulation.

The remaining allegations of error focus principally on Section 58-9-330 which is discussed, supra., at pages 10 - 11. That discussion need not be repeated. The Commission is compelled to clarify Order No. 90-849 to the extent it causes the Consumer Advocate to believe that it permits the sharing of profits for whatever reason they are achieved if the rate of return was in excess of 250 basis points above the threshold. Order No. 90-849 does not operate that way.

Order No. 90-849 makes it very clear that "[a]ny earnings above the ceiling will be refunded or credited to the ratepayers." Order at 12. The ceiling is set 250 basis points above the threshold rate of return. Any earnings over that point would be

strictly ratepayer earnings and the LEC would not be entitled to any of these earnings. The only earnings in which the LEC has an interest are those between the floor and the threshold, which the LEC is allowed to keep, and those between the threshold and the ceiling, which the LEC must share on a 50/50 basis with the ratepayers. In addition, the filing requirements and the Commission's review thereof should deal with the Consumer Advocate's concern that profits may be maintained for whatever reason they are achieved. The Commission intends to closely scrutinize the revenues, expenses, investment, consolidated cash flow, and the LEC's efficiencies and productivity of any LEC choosing to opt for incentive regulation. The intent of incentive regulation is to encourage the utility to operate more efficiently, thereby benefiting the ratepayers. Clearly, the ratepayer is better served under this refinement to the existing regulatory scheme in South Carolina as this trial brings about the Commission's intended objective.

The Consumer Advocate also asserts insufficient findings in Order No. 90-849 to support the Commission's use of return on equity as a benchmark return for the local companies. For as long as the Commission has regulated telephone utilities, the rate of return determination must, by definition, be based on either the total investment of the utility or the equity component thereof. See, Order No. 85-1 in Docket 84-308-C.

In the record in this proceeding, a difference of opinion was expressed as to whether equity or investment was a better measure of rate of return. GTE urged that a return on investment as opposed to a return on equity was appropriate (Tr. Vol. II, p. 53). The Commission, sua sponte, takes judicial notice of the fact that some jurisdictional telephone utilities do not even have an equity component to their capital structure. Southern Bell speaks only in terms of a "rate of return" (Tr. Vol. II, p. 103). United Telephone speaks in favor of using a return on investment (Tr. Vol. II, p. 146). Staff witness Walsh, on the other hand, urges that rate of return should be based on the particular method of regulation, i.e. either investment or equity, based upon the manner in which that utility is presently regulated (Tr. Vol. I, p. 13). In any event, the Commission has determined that either investment or equity may serve as the basis for establishing a rate of return and that the specific determination should be made on a case by case basis.

Having disposed of the specific arguments raised by the SCCTA and the Consumer Advocate, the Commission now addresses the SCCTA's request for a stay of Order No. 90-849 pending the appeal thereof. The granting of a stay is peculiarly within the discretion of the Commission and even when a stay is requested, it is not mandatory that it be granted. See Code Section 1-23-380(c); City of Spartanburg v. Belk's Department Store, 199 S.C. 458, 20 S.E.2d 157 (1942).

In the instant case, the SCCTA has not made showing of a need to maintain the status quo. Indeed, as Order No. 90-849 does not result in any increased rates and charges to consumers nor does it result in any increase in profits to a utility without further action on the part of a LEC wishing to be incentive regulated and further proceedings before the Commission. A stay of the generic order, which refines the method of regulation of telephone utilities, is not appropriate. Therefore, this request is denied.

In support of Order No. 90-849, and in support hereof, the following additional Findings of Fact and Conclusions of Law are asserted.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. Competitive forces have emerged in the telecommunications industry in South Carolina over the last six years (Tr. Vol. I, p. 12).

2. The natural monopoly characteristics of telecommunications are now facing changes. These changes come in large part from expanding technology and the resulting expansion in competition (Tr. Vol. II, p. 82).

3. Since 1984, the Commission has authorized 2 carriers competing authority with the local exchange companies for the provision of access services (Tr. Vol. I, pp. 61-62).

4. Since 1984, the Commission has authorized 31 carriers to resell intraLATA toll and point to point interexchange services in direct competition with the local exchange companies (Tr. Vol. I, pp. 61-62; p. 36).

5. Since 1984, the Commission has authorized over 700 carriers to offer coin/coinless telephone services in direct competition with the local exchange companies for the provision of such services (Tr. Vol. I, pp. 61-62; p. 36).

6. Competition is emerging in the area of billing and collection services as both the independent telephone companies and third parties construct their own data bases for these services (Tr. Vol. I, p. 46).

7. There is presently a competitive alternative to the LEC's MTS, WATS, 800 and private line services (Tr. Vol. II, pp. 29-30).

8. In the local market, cellular radio, shared tenant services, cable television, fiber optic and alternative access providers have emerged as present and/or potential competitors to the local exchange companies (Tr. Vol. II, p. 44).

9. A large portion of the local exchange companies' revenues are derived from toll and network access services, a dependence viewed with concern as these services are subject to greater competitive pressures (Tr. Vol. II, p. 84).

10. The telecommunications services marketplace is in a state of transition reflecting more competition (Tr. Vol. II, p. 77), including, but not limited to, the following:

A. Some real estate developers have begun to incorporate telecommunications services as an integral part of the buildings' services. Apartment buildings have master antennas and cabling for broadband services (Tr. Vol. II, p. 44).

B. The State of South Carolina has begun "competing" with the local exchange companies by constructing its own private network (Tr. Vol. I, p. 59).

C. Financial institutions have installed their own private networks utilizing "very small aperture terminus" data transmission facilities (Tr. vol. I, p. 60).

D. While there are presently no fiber rings in South Carolina, they are under construction in Atlanta, Miami and Orlando. As South Carolina is a typical sunbelt state, there is no reason to believe such facilities will not soon be offered in South Carolina (Tr. Vol. II, p. 127).

11. Telecommunications technology is advancing and competitive pressures on non-basic services are increasing (Tr. Vol. II, p. 95).

12. The National Telecommunications and Information Administration, which acts as a policy advisory group to the White House, has indicated that some 39 states have explored the need for some type of regulatory reform (Tr. Vol. II, p. 140).

13. A fundamental purpose of telecommunications policy is to ensure the availability of efficiently produced, affordable, quality telecommunications services (Tr. Vol. II, p. 46).

14. The ultimate goal of the Communications Act of 1934 was, and is, the provision of "Universal Telephone Service" (Tr. Vol. II, p. 78).

15. Of the various regulatory actions taken by other state Commissions, earnings sharing represents only a refinement to

traditional rate of return regulation as earnings between certain levels are shared between ratepayers and the utility (Tr. Vol. II, pp. 93-94).

16. Changes in the telecommunications industry, such as a advancement in technology and the advent of competition in certain markets, warrant the consideration of an alternative to traditional earnings regulation of local exchange companies (Tr. Vol. I, p. 93).

17. Incentive regulation involves changes in the rules regarding rates of return; not changing substantially other aspects of rate of return regulation. Instead of setting a single rate of return, regulators set a rate of return band using a floor, a benchmark, a threshold and a ceiling (Tr. Vol. II, p. 51).

18. The current regulatory process should continue as it does now, however, some refinements are appropriate. Refinements designed to encourage the LEC's to become more efficient, while confronting enhanced competition, are necessary if the public interest is to be served (Tr. Vol. II, p. 89). To that end, the Commission has set forth reporting requirements to monitor the efficiencies and to judge the impact of incentive regulation on the LEC and its ratepayers. Those reporting requirements are contained in Appendix A and incorporated by referenced herein. Those reporting requirements may be modified or amended as conditions warrant or as may be suggested by participating parties when a LEC files for incentive regulation treatment.

19. The LEC's are taking the risk of earnings below the benchmark return which would require their shareholders or investors to absorb down to the level at which the utility could file for rate relief (Tr. Vol. I, p. 51).

20. Upon adoption of refinements to the current method of regulation, the Commission will still maintain the same regulatory control that they currently maintain (Tr. Vol. I, p. 49).

21. At the end of a twelve month period, the Commission Staff Accounting Division would audit an opting telephone utility to determine the impact of incentive regulation on that local exchange company (Tr. Vol. I, p. 22).

22. Consumer benefits to a refined regulatory plan include continuation and perpetuation of affordable, quality basic local service provided by a more efficient and productive utility.

23. New products and services should be forthcoming because of the incentives provided and the resulting more deployment of new technologies (Tr. Vol. II, p. 106).

24. Different services provided by the LEC's face different degrees of competition. This is a dynamic situation headed in the direction of more competition and more customer choices (Tr. Vol. II, p. 102).

25. The jurisdictional telephone companies are entitled, as a matter of law, to be afforded the opportunity to earn a fair rate of return on its jurisdictional investment. Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923).

26. The Commission is vested with the power and jurisdiction to supervise and regulate the rates and services of every public utility in this state and to fix just and reasonable standards, classifications, regulations, practices and measurements of service to be furnished, imposed or observed and followed by every public utility in this state. Code Section 58-3-140.

27. The Commission may utilize its experience, technical competence and specialized knowledge in the evaluation of the evidence. Code Section 1-23-330(4).

28. The Rules of Evidence as applied in civil cases in the Court of Common Pleas likewise apply in contested matters before the Commission. Code Section 1-23-330.

29. The incentive regulation methodology represents a refinement to the previous practices of the Commission. The weighing of the evidence and the drawing of the ultimate conclusion therefrom as to what return is necessary to enable a utility to attract capital is a matter peculiarly within the province of the Commission. Southern Bell Tel. & Tel. Co. v. Public Service Commission, 244 S.E.2d 278 (S.C. 1978).

NOW, THEREFORE, having reconsidered the record in the specific context of the issues raised by the SCCTA and the Consumer Advocate,

IT IS ORDERED:

1. That Order No. 90-849 is affirmed and is supplemented by the provisions of this Order including the narrative portion, findings and conclusions hereof;

2. That Order No. 90-986 is hereby rescinded and has no force and effect.

3. That the SCCTA's request for Stay of the Operation of Order No. 90-849 is denied as no foundation has been laid therefore. Further, under the determination that the refinements to the existing regulatory scheme are in the public interest, a stay of the operation of Order No. 90-849 would be in conflict therewith.

4. The Commission hereby places all LEC's and other parties on notice, that in any proceeding whereby a LEC seeks to be subject to the Commission's incentive regulation plan, that the Commission intends to support discovery requests of parties which are reasonably calculated to produce data which may lead to relevant evidence.

BY ORDER OF THE COMMISSION:

Marjorie Amos-Frazier
Chairman

ATTEST:

Executive Director

(SEAL)

DOCKET NO. 90-266-C - ORDER NO. 90-986
OCTOBER 19, 1990
APPENDIX A

1. Identify changes in expenses for Total company Regulated and Intrastate Regulated Operations:

   a. Actual dollar amount of aggregate expenses to include plant non-specific, plant specific, customer operations expense, and total operation expenses.

   b. Supply information in 1(a) to reflect the elimination of annual inflation.

   c. Supply information in 1(a) to reflect the individual expense items by specific account.

   d. Provide a monthly calculation of cost per access line.

2. Identify changes in revenues for Total Company Regulated and Intrastate Regulated Operations:

   a. Actual dollar amount of aggregate revenues to include Local Network Service, Network Access Service, Long Distance, Miscellaneous, Uncollectibles, and Total Operating Revenue.

3. Identify changes in Expenditures for Plant and Equipment for Total Company Regulated and Intrastate Regulated Operations:

   a. Actual dollar amounts to include changes made during the year in accounts representing plant and equipment, according to Uniform Systems of Accounts for Telephone companies.

4. Each utility must file a verified statement concerning operational efficiencies and any other consumer benefits which it feels have been achieved by virtue of this refinement to the utility's regulatory scheme. For example, a discussion of the investments made to improve efficiencies in operations, including the capital and associated expense savings associated therewith, should be filed.

5. Provide a consolidated cash flow statement for South Carolina operations.

6. Provide the dollar amount of assets invested in regulated and non-regulated operations in South Carolina.